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C O N F I D E N T I A L AIT TAIPEI 000674

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SUBJECT: TAIWAN PREPARES TO ALLOW PRC INVESTMENT

REF: TAIPEI 670

Classified By: Economic Chief Hanscom Smith for reasons
1.4 (b) and (d).

¶1. (C) SUMMARY. In early July, Taiwan plans to open its economy to PRC investment for the first time. Although Taiwan is by some measures the largest external investor in Mainland China, Taiwan has cited national security grounds in banning virtually all PRC investment in its own economy. Taiwan is tentatively slated to open portions of its manufacturing, service, and construction sectors to the PRC starting in early July, and is also preparing immigration and other related measures to facilitate Chinese investment. High technology and other sensitive sectors, however, will not be opened to PRC investors. END SUMMARY.

¶2. (SBU) At then end of 2008, according to Taiwan data, Taiwan hosted cumulative foreign direct investment (FDI) of USD 102.3 billion, the equivalent of 26% of GDP. The U.S. is the largest foreign investor in Taiwan, with USD 21 billion in total investment, followed by the Netherlands, at USD 16.8 billion, British Caribbean territories, at USD 16.6 billion, and Japan, at USD 15.8 billion. For tax purposes, many EU member countries opt to invest in Taiwan via the Netherlands.

¶3. (C) Taiwan first allowed investment in China via third countries in 1989, and has allowed direct investment in the PRC since 1992, with some restrictions. Since much Taiwan investment in China actually takes place through Hong Kong, the Cayman Islands, the British Virgin Islands, and other jurisdictions, it is difficult to gauge the exact amount of Taiwan investment in the Mainland. Official Taiwan figures put the level at approximately USD 75.6 billion, although the actual amount is likely well in excess of USD 100 billion. On national security grounds, Taiwan has banned Chinese investment, although an undetermined amount of PRC capital has reached Taiwan through other jurisdictions. The Taiwan business community has long been anticipating official relaxation of Taiwan's ban on investment from the PRC, its largest trading partner. On April 29, for example, the Taipei stock exchange surged 6% in the wake of reports that a Chinese telecommunications firm planned to buy a stake in Taiwan's FarEastOne telecom group. (NOTE: Although Taiwan has allowed PRC qualified domestic institutional investors, or QDIIs, to trade stocks in Taiwan, our TAIEX contacts say

Chinese investment in Taiwan stocks is pending completion of a Taiwan-PRC securities MOU.)

14. (C) During a June 4 meeting with Econ Chief, Mainland Affairs Council (MAC) Vice Chairman Fu Don-cheng said Taiwan is scheduled to announce the opening of its economy to PRC investment in late June, and that such investment will be allowed from early July. Separately, MAC contacts told us that restrictions on Mainland investment will end on July 1. According to Fu, approximately 30% of Taiwan's manufacturing sector, 20% of the service sector, and 15% of the construction sector will be opened to PRC investment. Fu did not, however, have more specific details as to exactly which portions of each sector will be available for Chinese investment. He did note, however, that significant parts of the telecom sector will be placed off-limits, and that the FarEastOne investment announced in April will not in fact be approved. The Executive Secretary of the Ministry of Economic Affairs' Investment Commission, Fan Liang-tung, also told us the telecom deal will not be approved.

15. (C) In a recent meeting, Hwang Jung-chiou, one of three Vice Ministers of Economic Affairs, told us that Chinese investors will be allowed to own up to 100% of companies in some manufacturing sectors, but that PRC investments in the service and public construction sectors will be regulated on a case-by-case basis. In addition to portions of the telecom sector, he explained, PRC investment will also be prohibited in the semiconductor, integrated circuit (IC) design, IC packaging/testing, and other sensitive sectors. According to the Investment Commission's Fan, Mainland investment will not be allowed in sectors dominated by one or two firms. He estimated that investment in public construction projects will be limited to between 30 and 50 percent of the total cost of the project, but added that such investments would be assessed on a case-by-case basis. Another requirement being considered, according to Fan, is requiring annual reports to the Investment Commission by investing companies with at least NTD 80 million (USD 2.5 million) capitalization.

16. (C) Fu said Taiwan is also planning to implement immigration and other related measures designed to facilitate PRC investment. In general, he explained, Chinese investors will be treated in a way similar to other "foreign" investors. He noted that although Taiwan has allowed PRC nationals to buy real estate since 2002, only a handful of such transactions have occurred given what Fu described as Chinese reluctance to allow that type of investment. Fu explained that Taiwan now plans to allow PRC nationals to buy both residential and commercial real estate. To avoid a housing bubble, however, Chinese nationals will not be able to transfer ownership, or "flip", houses within the first three years after purchase. According to Fu, Taiwan will allow Chinese "white collar" investors to live in Taiwan for one year, with an option for extending until up to six years. Given political sensitivities over unemployment, however, work permits for Chinese investors will not be issued until after Taiwan's local elections in December.

17. (C) In April, Minister-of-state for Economic Affairs Chu Yun-peng resigned after a media expose documented his repeated personal travel during working hours. Chu, whose portfolio included cross-Strait issues, recently told us that Chinese investment will only be allowed via a "positive list" format that explicitly identifies which sectors are open to the PRC. Chu cautioned that the Ma administration has done relatively little preparatory work on associated measures such as how to handle immigration and residency procedures for Chinese investors, and asserted it will be "a very long time" before Taiwan actually sees any Chinese investment.

18. (C) COMMENT. Assuming it is implemented as planned in the near future, Chinese investment will help ease Taiwan's current economic downturn, the worst in its history. While some fear PRC investment could erode Taiwan's economic sovereignty, many in the Taiwan business community are eager for an infusion of Chinese cash. Mindful of public concerns, the Ma administration appears to be pursuing a calibrated

strategy that opens job-rich sectors such as manufacturing and construction while keeping high technology and other economic "crown jewels" off limits from Chinese capital. END COMMENT.

WANG